THE SEC INTERPRETIVE AND ENFORCEMENT PROGRAM UNDER THE FCPA

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I. INTRODUCTION

My remarks will conclude the discussion of what the Foreign Corrupt Practices Act[1] is and how it works. I am going to discuss the role of the SEC in interpreting and enforcing the Act.

The SEC is actively involved in interpreting and enforcing the Act. Because the Act's bribery provisions are unlike most of the other provisions of federal securities law, one might wonder why the SEC has that role. In 1933 and 1934 there was some debate about whether or not the federal government should audit the books and records of corporations to determine whether their disclosures were accurate. Congress rejected the notion of auditing the corporations as an unwarranted intrusion into the private sector. The SEC has ever since been trying to gather that authority, and by taking an active role in interpreting and enforcing the Act, the SEC has been able to assert some authority in that area. That intrusion has resulted in much kicking and screaming in the corporate community. The Foreign Corrupt Practices Act suffers because lawyers are unable to decide precisely where lines are going to be drawn. Lawyers have quibbled over some very insignificant matters in the Act. Congress is now scrutinizing the Act, trying to get an overall sense of it. Those who must comply with the Act need to be able to predict how it will be interpreted.

It is particularly necessary to have consistent interpretation and predictability in the regulatory area. If the Act confined itself to overseeing the keeping of accurate corporate books and records, there would be little controversy. However, the reach of the Act is not entirely clear, and the difficulty which corporations and businessmen experience when trying to comply with it has an

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1. Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, §§ 102-104, 91 Stat. 1494 (codified at 15 U.S.C. §§ 78a, 78m, 78dd-1, 78dd-2, 78ff (Supp. V 1981)), *reprinted in* Appendix I, *infra*.

adverse impact on foreign commerce. In addition, the Commission has created restraints in the corporate accountability area, the corporate governance area, and the corporate perquisites area.

From the early 1970s until the present, the Commission has sought to instill new values in the business community. Early in its involvement, during the Watergate period, the SEC discovered that there were slush funds in corporations. Watergate did for political and corporate power what Vietnam did for police actions: it brought them into our living room and gave them a bad name. We saw a line of rather seedy characters closely associated with the President of the United States, and we heard about bad people working for some of the largest corporations in the country. I think the public, whatever it may be, had its nose rubbed in the raw workings of power. The late 1970s experiences caused many people to distrust public fiduciaries. As a result, we created the Ethics in Government Act,[2] which is a novel extension of law into a new field. We also created the Foreign Corrupt Practices Act, which does to corporations what the Ethics in Government Act does for public fiduciaries.

II. THE SEC'S ENFORCEMENT ROLE

The SEC did not actively support the bribery provisions[3] of the Foreign Corrupt Practices Act. Indeed, it's not entirely clear that they have any interest in prohibiting bribery per se. Their interest is making sure that disclosures are made to public investors, and in that respect, the SEC represents the public interest. But to really understand how the SEC is affecting the public interest, we must examine what is meant by "the public interest." What public is the SEC representing? There is a myth about widows and orphans who invest their life savings and equity securities in major corporations, and are at the mercy of the limited disclosure documents which corporations are forced to make in order to market their securities. There is a tug of war between how frank disclosures must be, and how to color negative information so as to still be able to sell securities when your sales are going down. The SEC is often balancing those conflicting notions. The SEC's interpretation of questionable payments and how

2. Ethics in Government Act of 1978, Pub. L. No. 95-521, 92 Stat. 1824 (codified in scattered sections of 2, 5, 18, 26, 28 U.S.C.) (Supp. IV 1980).

3. 15 U.S.C. § 78dd-1, (Supp. V 1981).

they must be disclosed under the federal securities laws is determined from an advocate's viewpoint—that these things must be disclosed for public investors because they are material to public investigations. There are some serious questions as to the validity of the different theories which the SEC has advanced to explain the materiality of these disclosures under traditional federal securities law and analysis. Some have said that the SEC uses the Foreign Corrupt Practices Act to avoid having to test those theories in court under the existing antifraud reporting statutes. According to this view, the Commission looks to the accounting provisions[4] of the Foreign Corrupt Practices Act to carry the day for them.

A. Beginnings: The Voluntary Disclosure Program

Because of its vigorous enforcement program, the SEC was given authority by Congress to enforce the bribery provisions with respect to the public corporation which issues securities, and to enforce the accounting provisions which are applicable to those corporations. It was given this role because the Commission had already shown an interest in enforcement. The SEC had used the Watergate revelations as an excuse to start a so-called voluntary disclosure program. In effect, the SEC announced to corporations that they had to disclose what they were doing. If they came in voluntarily they would not have to disclose the names of countries or officials, but could instead make a generic report on a Form 8-K. If, however, they had to be forced to disclose, things would not go so nicely. Those corporations would be required to make public disclosures, and complaints would be filed in court. That was the giant club which the SEC wielded in the voluntary disclosure program.

In the voluntary disclosure program, and its general investigation efforts, the SEC has looked at well over five hundred American corporations. Congress knew when it placed enforcement responsibility in the Commission that the agency would be a vigorous enforcement agency. That vigor has been exhibited, not in a large quantity of cases, but in the kinds of cases brought. They are carefully selected cases that have facts which support some of the very strained interpretations of the Act which the Commission advances.

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4. 15 U.S.C. §§ 78m(b)(2)(A), 78m(b)(2)(B) (Supp. V 1981).

B. Selected Cases

The first case prosecuted under the Act, *SEC v. Aminex Resources Corp.*,[5] was brought March 9, 1978, not long after the Act was passed. The SEC alleged misappropriation of assets. The misappropriations did not involve any foreign bribery scheme. Congress did not expressly provide for individual liability in the accounting provision of the Foreign Corrupt Practices Act. One would think, therefore, that these violations would be prosecuted under the reporting and antifraud provisions of the Federal Securities Act.[6] The SEC, however, alleged aiding and abetting violations by the individual officer involved, and decided that these acts were, in fact, violations of the antifraud provisions. Thus, they preserved the notion that a violation of the accounting provision was also a violation of the antifraud provision, even though Congress was careful not to characterize them as such when the Foreign Corrupt Practices Act was passed.

This very interesting first case contains a number of aggressive interpretations of the Act. For example, *Aminex* involved transactions which had occurred some time before the effective date of the Act. The Commission glossed over that point and alleged that, since the accounting provisions require a corporation to make and keep accurate records, by not correcting their books after the effective date of the act the corporation was maintaining false entries. The Commission also obtained disgorgement of the money which had been misappropriated, and it was returned to the corporation. Thus they established that, under the Act which did not provide any such express remedies, relief of that kind was available. Perhaps the most significant fact, however, was that the defendants consented to a judgment without litigating any aspect of the case. In fact, of the fourteen or so cases brought under the Act, none have involved an adjudicated decision by a court on any of the positions which the SEC has advanced. Some cases are still pending, but there have been no final decisions handed down. Most corporations would rather accept an injunction, return the money, and allow some other party the role of standing up to the SEC's interpretations in this area.

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5. SEC v. Aminex Resources Corp., No. 78-0410 (D.D.C. filed Mar. 9, 1978). Complaint and temporary restraining order *reprinted in* [1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,352.

6. Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-kk (1976).

The second case brought by the SEC, one month later, was *SEC v. Page Airways, Inc.*[7] Although this case involved foreign bribes, the bribes occurred before the effective date of the Act. Because the SEC could not reach it under section 30-A, it turned once again to the accounting provisions. The theory remained the same: corporations had to correct their books and records to reflect the things done in the past which were not wrong at the time but are considered wrong under the Act.

The third case, *SEC v. Katy Industries, Inc.*,[8] actually involved a violation which occurred after the effective date of the Act. The SEC had found that payments had been made before the effective date of the Act, but couldn't reach them under section 30-A. However, in searching for violations the SEC found a contract to make prohibited payments in the future. That was found to be a "promise to pay" under the Act, which was prohibited, even though no payments had been made under their contract after the effective date of the Act. The SEC decided that if a contract were made where a party knew or had reason to know that proceeds would go to a high level government official, that constituted a sufficient violation of the Act.

That was not a bad start for the first three cases in the first year of the Act. It is true that the SEC has not brought many cases. It is a very small agency and has a rather large constituency that it has to police. But it is highly effective, and sends staff members out to conduct programs which advocate some of its more aggressive interpretations of the Act. The corporate community cannot sit back and wait and see how the law develops. Because it makes sound business sense to comply with federal regulatory authorities without a public clamor, corporations must conform their activity in ways which the agency requires. To do otherwise would mean that the corporations would be risking substantial litigation expenses and adverse publicity.

The fourth case the Commission brought under the Act, *SEC v. Marlene Industries*,[9] was begun approximately a year after the Act was passed. This case resurrected the SEC's old campaign

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7. SEC v. Page Airways, Inc., No. 78-0656 (D.D.C. filed Apr. 12, 1978). Complaint *reprinted in* [1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,393. Subsequently, this case was transferred to the Western District of New York. *See* [1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,717.

8. SEC v. Katy Industries, Inc., No. C78-3476 (N.D. Ill. filed Aug. 30, 1978).

9. SEC v. Marlene Industries, No. 79 Civ. 1959 (S.D.N.Y. filed Apr. 16, 1979).

against unreported corporation perquisites for its officers and directors. In *Marlene*, two brothers, who served as officers and directors in the corporation, were paid sums from the corporate accounts for travel which never took place, and were allowed credit cards which apparently were not used for business purposes. It was decided that these were violations of the accounting provisions. There was no foreign bribery involved; the SEC was once again intruding into the adequacy of records kept by a private corporation.

C. The SEC Releases

All of these cases held that the separate antifraud and reporting provisions of the federal securities laws had been violated, as well as the Foreign Corrupt Practices Act. At the same time that the SEC was waging this rather aggressive enforcement campaign, it was also actively disseminating its interpretations of the Act. The SEC issued a number of releases to guide the community. The first release under the Act announced that the SEC intended to make use of its new authority.[10] Approximately a year after the enactment, the Commission issued regulation 13B, its rules under the accounting provisions.[11] These rules make it an offense to falsify records or to lie to your accountant. The Commission had initially proposed these very provisions to Congress as part of the Act. Although Congress rejected the provisions, the SEC took this new opportunity to secure the provisions by regulation. The validity of those regulations has neither been challenged nor adjudicated.

In 1979 the Commission proposed the requirement that a corporation must file, in its annual report, a statement by management concerning the corporation's internal control systems.[12] The purpose of that report, according to some, was to require a corporation to make affirmative disclosures about their internal accounting systems. Then, if those disclosures were false or misleading, they could themselves be grounds for an antifraud investigation. The Commission's initiative in this area was strongly resisted by

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10. Notification of Enactment of Foreign Corrupt Practices Act of 1977, 43 Fed. Reg. 7752 (1978).

11. 17 C.F.R. §§ 240.13(b)(2)(1)-(2) (1979).

12. Statement of Management on Internal Accounting Control, Securities Exchange Act Release No. 15772 (Apr. 30, 1979), [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,063.

many corporations which were, at the same time, making voluntary disclosures. In 1980 the Commission withdrew its initiative, and it has never required a management statement on the internal accounting control system as a line item in Form 10-K.[13] In January of this year, the SEC issued another ruling saying that the private sector initiatives in this area are sufficient.[14] This is another example of the Commission using a club to get "voluntary" compliance from the corporation community.

The Commission came under fire for both the bribery and the accounting provisions because it did not provide guidance by regulation, but relied instead upon individual complaints. Many people believed that this piecemeal approach was not a good way to proceed. The SEC was urged by some to adopt a program for reviewing proposed transactions similar to one run by the Justice Department.[15] The Commission became concerned that this Act, particularly the antibribery provision, would have an adverse impact upon business. The SEC requested information from anyone who was being adversely impacted. In 1980 a Securities Exchange Act Release requested comments about the manner in which corporations were hurt doing business in foreign countries.[16] They issued another release several months later indicating that they had not heard from anybody. Consequently, the SEC would not have any program under section 30-A.[17] The SEC said they would defer to the Department of Justice in determining whether to prosecute under the Act.[18]

Recently, the Commission issued a release which says that things are working well under the Justice Department programs. There have been a handful of letters from the Justice Department,

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13. Statement of Management on Internal Accounting Control, 54 Fed. Reg. 40,134 (1980).

14. Statement of Management on Internal Accounting Control, Securities Exchange Act Release No. 34-18451 (Jan. 28, 1982), SEC. REG. & L. REP. (BNA) 220-1 Vol. 14, No. 5 (Feb. 3, 1982).

15. Department of Justice Review Procedure, Foreign Corrupt Practices Act of 1977, 28 C.F.R. § 50.18 (1980). *See also* Department of Justice, Foreign Corrupt Practices Act Review Procedure, 45 Fed. Reg. 20,800 (1980).

16. Impact of the Antibribery Prohibitions in Section 30A of the Securities Exchange Act of 1934, Securities Exchange Act Release No. 16593 (Feb. 21, 1980), [1979-80 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,454.

17. Statement of the Commission, Policy Concerning Section 30A of the Securities Exchange Act of 1934, 45 Fed. Reg. 59,001 (1980).

18. *Id.*

but no floodgate of corruption. Consequently, the SEC will continue to defer to the Department of Justice.[19]

A report of the General Accounting Office,[20] gathered the empirical data which the Commission had been unable to secure by the public comment process. It severely criticized the Department of Justice and the Commission for not providing guidance in the area of accounting. In response to this criticism, the then Chairman of the SEC, Harold Williams, drew some guidelines in a well-publicized speech in January, 1981.[21] The speech stated that the record-keeping provisions of the accounting section would apply to records which are relevant to the system of internal control. It did not concede that the records or the system were designed to prevent foreign bribery, but it did concede that the records did not have to include every scrap of paper documenting every single transaction. For travel vouchers, all you need to have are the records which are relevant to the system of controls. And the system of controls, the SEC now tells us, need only be "reasonable." The SEC will defer to the reasonable business judgment of a corporation in making a decision about the control necessary in a given circumstance for that corporation.

In January, 1981, three years after the Act took effect, the Commission said that inadvertent accounting mistakes would *not* be subject to enforcement action by the SEC. They have maintained that reckless conduct suffices to violate the accounting provision, and have brought at least one enforcement action for alleged reckless conduct.

If the SEC were to bring the enforcement action, it would be unlikely that they could obtain an injunction unless they were able to demonstrate that there was a reasonable likelihood that the conduct in question would be repeated. That has been the subject of much litigation under federal securities laws generally.

Finally, the Commission has provided guidance concerning when and under what circumstances the conduct of subsidiaries

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19. Statement of Commission Policy Concerning Section 30A of the Securities Exchange Act of 1934, Securities Exchange Act Release No. 34-18255 (Nov. 12, 1981), SEC. REG. & L. REP. (BNA) No. 629 (Nov. 18, 1981).

20. Government Accounting Office, Impact of Foreign Corrupt Practices Act on U.S. Business at 14-15 (Mar. 4, 1981).

21. Statement of Policy on SEC Enforcement of Foreign Corrupt Practices Act's Accounting Provisions, 46 Fed. Reg. 11,544 (1981) (address of SEC Chairman Harold M. Williams to the SEC Department Conference of the American Institute of Certified Public Accountants, Jan. 13, 1981).

will be attributed to the corporate parent. The SEC had long maintained that the sins of the subsidiary would be visited upon the parent. They have a rather elaborate structure for determining what level of sin, and what degree of control over the subsidiary are necessary. We now know that the books, records, and internal control systems of subsidiaries must comply with the Act.

III. CONCLUSION

During the past two years, the SEC appears to have taken a less aggressive stance in the enforcement and interpretation of the Act. This indicates that even independent regulatory agencies change in response to changes in the administration and changes in the political world. Since the Corporate Practices Act was passed there have been numerous changes in personnel. Among the new people are the director of the Division of Enforcement, the General Counsel, the Chairman, and four new commissioners. Thus, there are new people facing new interpretations. They have informed Congress that they are uninterested in bribery issues, which they are turning over to the Department of Justice.[22] It is unusual for the Commission to give up any authority, so that, in and of itself, is a startling development in the securities trade. They seem to be divorcing themselves, or trying to divorce themselves, from the raging controversy over whether or not it is a bad thing to bribe people in foreign lands to get business.

They want to hold on, however, to the accounting provisions. I suspect they will vigorously pursue S. 708,[23] which gives them precisely what they now have in the accounting area. If they can hold on to this accounting tool, I predict the SEC will maintain a lower profile in the area of the enforcement of foreign payments. The SEC will heed the Department of Justice in the bribery area but continue to vigorously assert its authority over all corporations under the accounting provisions.

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22. *Business Accounting and Foreign Trade Simplification Act, Joint Hearings Before the Subcomm. on Securities and the Subcomm. on International Finance and Monetary Policy of the Comm. on Banking, Housing, and Urban Affairs*, 97th Cong., 1st Sess. 282, 288 (1981) (statement of John S.R. Shad, SEC Chairman).

23. S. 708, 97th Cong., 1st Sess., 127 CONG. REC. 13,983-85 (1981). These proposed changes to the FCPA are *reprinted in* Appendix II, *infra*.